The Role of Micro and Small Enterprises in Employment Creation

In the early 1990s, the Government of Ethiopia introduced an agriculture-based development strategy known as Agricultural Development Led Industrialization (ADLI). The basis for adoption of this strategy is the conviction in strategic importance and centrality of the agricultural sector for the overall economy, on account of its superior production, consumption and employment linkages. The main challenge for the economy is how to create more jobs to absorb the growing labour force, as well as to increase labour income. It is widely recognized that employment, earnings and the labour markets play a crucial role in poverty reduction through promoting both economic growth and enhancing its effectiveness in reducing poverty.

Cognizant of this, the Government of Ethiopia gives due emphasis to employment creation, in the context of poverty reduction through creating employment opportunities and using labour resource for growth as one of the most important resources the country. Cognizant of this, MSEs are considered to be critical in kick starting broad-based industrial growth and enhance employment creation. The Ethiopian government issued the National Micro and Small Enterprises (MSE) strategy in 1997 as revised in 2011 and established the Federal Micro and Small Enterprises Development Agency (FMSEA) to harness the benefit of such strategy. The development of small and micro enterprises has been the strategic focus of the industrial development initiative as reflected in its medium-term development plans. Job creation has been articulated as one of the eight pillar strategies of the Plan for Accelerated and Sustained Development to End Poverty (PASDEP). Subsequent development plans such as the first and second Growth and Transformation Plans (GTP-I (2010/11-2014/15) and GTP-II (2015/16-2019/20)) also recognize the critical role of private sector development for employment creation, especially through the development of SMEs and labour-intensive manufacturing industries.

Although broad-based growth and transformation through the promotion of micro and small enterprises (MSEs) has been underscored in various development plans in Ethiopia, both the level of unemployment and quality of jobs remain a concern. In order to make the MSE sector the engine of economic growth, reduce the problem of unemployment, and trigger industrialization, it is important to understand what factors determine growth and investment in innovation in MSEs in the context of Ethiopia.

In this study, we provide a microeconomic evidence on the determinants of firm performance in Ethiopia, with a focus on MSEs. The main objective of this study was to identify the determinants of

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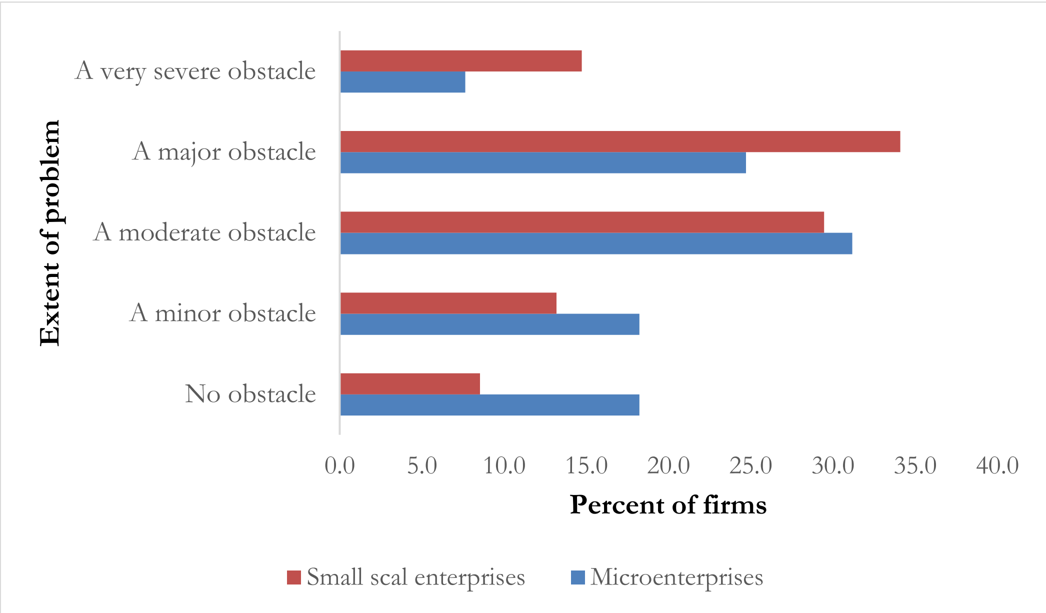
growth MSEs and of investment in innovation in MSEs using a survey of 300 firm level data from Addis Ababa, Ethiopia.

About 53% (78%), 19% (9%) and 28% (15%) of microenterprises (small enterprises) reported as growing, stagnant and declining, respectively. In both enterprise types, the self-reported proportion of stagnant firms is small, but the share of firms who reported a declining performance is higher in micro enterprises compared with small enterprises. Even though further investigation on the reasons why these firms are not growing is needed, these results show that interventions are required to reduce the share of survivalist and declining enterprises.



The result shows that MSEs have limited linkages with other firms, and are less integrated with the external market, suggesting MSEs, especially small enterprises have not benefited from linkages with larger firms. In addition, limited integration with the external market means that MSEs, especially small scale enterprises have not benefited from technology transfer and other useful business related exposures.

A majority of the enterprises, 79% and 72%, micro and small enterprises, finance their businesses from their own source, respectively. This implies that the proportion of enterprises that finance their business through borrowing from banks is found to be insignificant despite availability of financial institutions in Addis Ababa. It seems that access to finance appears to be a very severe or major obstacle as reported by about 55% and 64% of micro and small enterprises. The problem of access to finance is more severe for small enterprises compared with micro enterprise as the latter often have access to microfinance institutions (MFIs). In the case of small enterprises, they are too big for MFIs in terms of the amount of loan they require, but they are too small for commercial banks in loan size, reflecting the missing middle financial intermediary that cater the needs of small enterprises.

Weak business environment adversely affects growth of firms. In particular, frequent power interruptions, lack of access to credit, and shortage of water is inversely correlated with growth of MSEs.

Overall, the findings of the study reveal that MSEs suffer from a host of internal problems (e.g. weak human resources and other assets) and of external factors including lack of access to credit, limited market facilities, power problems, policy and regulatory bottlenecks. For small enterprises, access to credit appears to be a binding constraint for their growth as they are 'too big' for microfinance institutions, but they are 'too small' for formal banks in terms of the size of loan, reflecting the 'missing middle financial intermediaries' that serve small enterprises. Hence without renewed focus on promoting firm growth, especially MSEs through improving access to warehouses, relaxing credit constraints, and improving the macroeconomic and regulatory environment, the potential for MSEs for creating more jobs will be severely compromised.

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